Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for	)	
Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier	)	
Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal	)	
Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

FNPRM COMMENTS OF GVNW CONSULTING, INC.
USF ISSUES

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EXECUTIVE SUMMARY

The logic behind the broadband take rate proposal was that if it is truly the public policy directive to incent a transition to broadband, then an appropriate way to accomplish this is to base future federal universal service support on achieving that precise goal. In its Transformation Order, the Commission instead has focused almost exclusively on managing all change to an artificial national cap as it has been unable to utilize a decade long record to reform the USF contribution mechanism. We believe the Commission's effort to date fails to meet the statutory test of providing sufficient and predictable support as is required by the tenets of the Telecommunications Act of 1996.

With regards to the requirements for referring other components to a Federal/State Joint Board, we believe that the law as prescribed in the Communications Act of 1934, as amended by the Telecommunication Act of 1996 in Section 410(c), requires that proposed changes to the jurisdictional separations of costs (as prescribed in the Part 36 rules) must be referred to a Joint Board.

Section 65.103 of the Commission's rules permits carriers to submit direct cases, reply comments and rebuttal testimony on interstate rate of return issues. This would have created an opportunity for impacted carriers to receive a fair and equitable hearing of the facts and circumstances in play during 2012. Instead, at paragraph 645 of the *Transformation Order*, the Commission shut off this option by waiving its own rules related to gathering factual information. In so doing, we believe that the Commission has formulated its tentative conclusion before thoroughly gathering and considering relevant information. This is no small thing, assuming that this rate-of-return adjustment could be in place for as long as the prior level has been in place, and thus has far-reaching impacts for rate-of-return carriers. The Commission's premature conclusion of a 9% interstate rate of return also appears to totally ignore the increased regulatory risk – driven in large part by the Commission's own *Transformation Order*.

Rural carriers must construct their networks that have been engineered to meet carrier of last resort requirements in a holistic and integrated fashion. There are no "modules" that can be removed, based on a regulator's view of what constitutes competition in a portion of the service area, without creating harm for the other areas served by the carrier. The entire network for each rural carrier was deployed under a set of rules prior to December 29, 2011 that created a reasonable expectation that recovery of costs would be allowed to occur. We believe that changing the rules in this fashion would be determined to be retroactive ratemaking.

In Appendix H of the *Order,* the Commission signals its intent to limit reimbursable capital and operating costs for rate of return carriers through the application of quantile regression analyses. We believe the Commission has erred in its attempt to apply such a model retroactively, has not properly selected its independent variables, has not properly accounted for the interrelationship between key variables, and should not apply this approach to ICLS payments for carriers.

We submit that the Commission's proposal to adopt regression caps that apply to legacy capital expenditures is unlawful and constitutes retroactive ratemaking. We believe that changing the recovery rules for investments placed into service prior to the effective date of the *Transformation Order* does not comport with the Act and basic rules of administrative procedure. Several parties have already filed Petitions for

Reconsideration, as well as sought review of this aspect of the decision with the Appellate Courts.

A thorough study of the data set prior to formulating a conclusion by the Commission staff would likely have uncovered several key variables that are presently missing from the proposed quantile regression. The proposed quantile regression approach does not utilize two important attributes of topography and geology for companies that operate in some of the harshest operating conditions in the United States. It seems illogical to assert that these carriers have been placed in a similarly-situated peer group if one chooses to ignore topography, geology and climatic conditions that serve to create much higher than average costs to operate.

We are concerned with the Commission's tentative conclusion in the *Transformation Order* that methods similar to the high cost loop support regression models will be used to limit costs that are eligible for the ICLS mechanism. We urge the Commission to proceed cautiously in this regard for several reasons. We respectfully recommend that the Commission address the inadequacies with the current regression proposal prior to introducing more problems that are certain to occur with a regression modeling effort for ICLS.

Introduction and Background

The purpose of these comments is to respond to the Further Notice of Proposed Rulemaking of the Federal Communications Commission released on November 18, 2011. For this initial comment date, the Commission seeks comment on certain additional issues in Section XVII A-K of the *Further Notice* related to universal service issues. We have focused our comments in this round to issues pertaining to the proposed Connect America Fund, the review of the authorized interstate rate of return for rural carriers, the proposed reductions to support when an unsubsidized competitors overlaps an incumbent's service territory, and criticism of the proposed quantile regression statistical limitation.

GVNW Consulting, Inc. (GVNW) is a management consulting firm that provides a wide variety of consulting services, including regulatory and advocacy support on issues such as universal service, intercarrier compensation reform, and strategic planning for communications carriers in rural America. We are pleased to have the opportunity to offer comments addressing the issues the Commission has raised in its *Further Notice*, as well as offer comments that relate to the *Transformation Order (Order*) released by the Commission on November 18, 2011.

B. CONNECT AMERICA FUND FOR RATE-OF-RETURN CARRIERS

A broadband take rate concept may be needed to fully realize the broadband levels needed in rural America

When the Commission signaled its original intent to pursue a National Broadband Plan, many areas of rural America expected that a comprehensive strategy that was focused to the needs of all Americans would follow. Sadly, that has not been the case. The Commission has focused instead in its *Transformation Order* on how to restrict funds for the highest cost to serve areas via exclusions, phase-outs and caps. We respectfully submit that a Connect America Fund mechanism will not be successful unless residents in the highest cost to serve areas have the ability to access reasonably comparable broadband services at a reasonably comparable price.

In the proposal offered last summer by the Rural Associations as a key component of the Consensus Framework, a metric that measured the "broadband take rate" to calibrate future Connect America Fund eligibility was included. The logic behind this proposal was that if it is truly the public policy directive to incent a transition to broadband, then an appropriate way to accomplish this is to base future federal universal service support on achieving that precise goal.

In its *Transformation Order*, the Commission instead has focused almost exclusively on managing all change to an artificial national cap[1] as it has been unable to utilize a decade long record to reform the USF contribution mechanism. We believe the Commission's effort to date fails to meet the statutory test of providing sufficient and predictable support as is required by the tenets of the Telecommunications Act of 1996.

[1] Proposing a quantile regression technique that results in negative impacts for over 40% of the subject carriers is at best a draconian approach.

A Separations Joint Board referral is appropriate in certain circumstances

Paragraph 1037 of the Further Notice questions whether the Rural Associations' proposal is consistent with the Federal State Joint Board's reform process for loop cost, and if there are components of the Rural Associations' plan that should be referred to the Joint Board.

GVNW believes the Rural Associations' revised allocation of loop cost attempts to recognize an additional allocation of loop cost to interstate associated with the interstate DSL service, which is consistent with the Joint Board's evaluation of loop cost. While the methodology offered by the state members of the Federal/State Joint Board differs from the methodology proposed by the Rural Associations, the direction of the proposals is consistent.

With regards to the requirements for referring other components to a Federal/State Joint Board, we believe that the law as prescribed in the Communications Act of 1934, as amended by the Telecommunication Act of 1996 in Section 410(c), requires that proposed changes to the jurisdictional separations of costs (as prescribed in Part 36) must be referred to a Joint Board.

C. INTERSTATE RATE OF RETURN REPRESCRIPTION

At paragraph 1057, the Commission offers its tentative conclusion that the authorized interstate rate of return "*should be no more than 9 percent*." This conclusion appears to be based, at least in part, on the Commission's overarching desire to measure all decisions against its arbitrary national budget cap for USF.

Since it has been over two decades since the last formal represcription, we would have expected that the Commission would have initiated a process to develop a methodology that would properly capture the circumstances that rate of return carriers face in the current environment. Using section 65.103 of the Commission's rules, this would have been possible as that section of the rules is the section that permits carriers to submit direct cases, reply comments and rebuttal testimony. This would have created an opportunity for impacted carriers to receive a fair and equitable hearing of the facts and circumstances in play during 2012.

Instead, at paragraph 645 of the *Transformation Order*, the Commission shut off this option by waiving its own rules related to gathering factual information. In so doing, we believe that the Commission has formulated its tentative conclusion before thoroughly gathering and considering relevant information. This is no small thing, assuming that this rate-of-return adjustment could be in place for as long as the prior level has been in place, and thus has far-reaching impacts for rate-of-return carriers.

The Commission's premature conclusion of a 9% interstate rate of return also appears to totally ignore the increased regulatory risk – driven in large part by the Commission's own *Transformation Order*.

D. ELIMINATING SUPPORT FOR AREAS WITH AN UNSUBSIDIZED COMPETITOR

At paragraph 1038 of the Further Notice, the Commission poses the question as to whether it should adopt rules so that rate-of-return carriers are not required to serve locations within their study area that is served by an unsubsidized competitor, and in turn will not receive support for those lines they choose to serve in the areas of competitive overlap.

Competitive overlap issues require further study and analysis

We respectfully submit that such an approach would be problematic for several reasons. First, rural carriers must construct their networks that have been engineered to meet carrier of last resort requirements in a holistic and integrated fashion. There are no "modules" that can be removed, based on a regulator's view of what constitutes competition in a portion of the service area, without creating harm for the other areas served by the carrier.

Second, the entire network for each rural carrier was deployed under a set of rules prior to December 29, 2011 that created a reasonable expectation that recovery of costs would be allowed to occur. We believe that changing the rules in this fashion would be determined to be retroactive ratemaking.

Third, we believe that such an approach would preclude a carrier from meeting its obligation under state rules to fulfill carrier of last resort (COLR) responsibilities. It appears that the Commission has not fully studied or contemplated this COLR issue. In its own rules, the Commission uses Section 214(e) (1) to require a carrier to advertise the availability of service throughout the study area. Segmenting portions of a study area would, at a minimum, complicate greatly this portion of the requirements and potentially add to customer confusion.

E. THE COMMISSION'S REGRESSION MODEL PROPOSAL TO LIMIT REIMBURSABLE CAPITAL AND OPERATING COSTS FOR RATE-OF-RETURN CARRIERS IS NOT WELL-DESIGNED

In Appendix H of the *Order,* the Commission signals its intent to limit reimbursable capital and operating costs for rate of return carriers through the application of quantile regression analyses. The Commission has proposed to use a dependent variable based on study area loop costs in each account and a series of independent variables. The *Further Notice* requests comments on this proposal. As we note below, we believe the Commission has erred in its attempt to apply such a model retroactively, has not properly selected its independent variables, has not properly accounted for the interrelationship between key variables, and should not apply this approach to ICLS payments for carriers.

<u>Applying Regression Analysis to Existing Investment Is Unlawful and Confiscatory</u>

Carriers have been operating, in some cases for decades, under a specific set of FCC and various state PUC rules through the effective date of December 29, 2011 of the Commission's *Transformation Order*. These rules permitted carriers to act as a carrier of last resort and provide service to customers in their territory.

Changing to another set of rules and applying those rules to legacy investment is grossly unfair, especially in light of the operating challenges faced in high cost to serve territory. The Commission's proposed quantile regression approach is based in part on the relationship of the study company to "similarly-situated peers." As stated in the Commission's October, 2011 *Transformation Order* at footnote 1 of Appendix H:

The term "similarly-situated peers" means that, based on data from all the carriers in the analysis, if there were (hypothetically) 100 study areas with independent variable values that were nearly the same as those with the study area in question, 90 of them would be expected to have equal to or less than the 90th percentile prediction. It does not mean the carriers with the most similar number of loops (or values of the other variables).

Ambiguity lies in the wording: "independent variable values that are *nearly the same* as those with the study area in question." Under the current wording, "nearly the same" is immeasurable. Until a measurement of similarity is imposed, the categorizing of companies as being similar under the Commission's current wording appears ambiguous and arbitrary.

We submit that the Commission's proposal to adopt regression caps that apply to legacy capital expenditures is unlawful and constitutes retroactive ratemaking. We believe that changing the recovery rules for investments placed into service prior to the effective date of the *Transformation Order* does not comport with the Act and basic rules of administrative procedure. Several parties have already filed Petitions for Reconsideration, as well as sought review of this aspect of the decision with the Appellate Courts.

<u>Independent Variables were not properly selected</u>

The benefit of a public policy process that sought input before reaching an unsupported conclusion is particularly apparent relative to the selection (or not) of the independent variables used in the quantile regression model. The Commission has proposed a number of independent variables that include the number of loops, number of households, urban-rural designation, and percentage quantity of water. Our initial analysis indicates that several of these variables used in the study to create the proposed regression caps are not statistically significant. While the FCC claims that statistical significance is not important for predictive purposes, we submit that any model used for descriptive or predictive purposes should at least be representative of the population it aims to describe or predict. Statistically speaking, the output of a model is only as good as the model itself.

A thorough study of the data set prior to formulating a conclusion by the Commission staff would likely have uncovered several key variables that are presently missing from the proposed quantile regression. The proposed quantile regression approach does not utilize two important attributes of topography and geology for companies that operate in some of the harshest operating conditions in the United States. It seems illogical to assert that these carriers have been placed in a similarly-situated peer group if one chooses to ignore topography, geology and climatic conditions that serve to create much higher than average costs to operate.

Some variables are interdependent, which is not reflected in Appendix H

Networks are deployed in a holistic manner, with choices being made with respect to levels of investment for the discrete piece parts. Savings in one area will create a need for more investment in a different account, such as reducing switching investment by investing in longer-lived cable and wire facilities. Failing to recognize the delicate interrelationship between key variables results in some disastrous unintended consequences for small carriers serving sparsely populated areas.

One example of a company that would suffer from disastrous unintended consequences of the Commission's proposed regression model is a small carrier serving approximately 4,000 square miles of service territory in some of the sparsely populated regions of California, The Ponderosa Telephone Company, headquartered in O'Neals, California. Over the last several years, Ponderosa has endeavored to reduce its software upgrade costs and annual maintenance contracts for eight Nortel DMS-10's by collapsing seven of those switches into one central switching point. In turn, this has necessitated spending additional money on subscriber carrier equipment (COE category 4.13) and cable and wire facilities to connect the remote points in the switching complex. Ponderosa has verified that its present switching costs are low relative to a group of similarly-situated companies (carriers in California, Oregon and Washington) by comparing its switching costs, using Local Switching Support (LSS) as a surrogate for that cost category, and it is in fact in the low end of that grouping.

The proposed quantile regression approach offered by the Commission would be extremely detrimental to Ponderosa, with a projected support reduction of over $140,000 per month. It is worth noting for Ponderosa that its costs/network configuration are reviewed on a periodic basis by the California Public Utility Commission, and have been determined to be reasonable. What it appears that the Federal Communications Commission is attempting to assert with its quantile regression approach is that 25% of the carrier's network cost assigned to the interstate jurisdiction should be viewed differently than the 75% of the network allocated to intrastate that has been reviewed by state regulators. In essence, the Commission has concluded that its quantile regression model more accurately reflects the cost of the network required to serve a particular area than can be determined by state regulators. We believe that in this case the FCC is off base.

By limiting individual accounts, we believe the Commission's proposal creates unintended yet serious consequences for carriers such as Ponderosa that have attempted to pursue efficient network design. Instead of properly recognizing the switching cost savings and the reasonableness of the entire network design, the quantile approach is punitive.

Applying a similar approach to ICLS would be problematic

We are concerned with the Commission's tentative conclusion in the *Transformation Order* that methods similar to the high cost loop support regression models will be used to limit costs that are eligible for the ICLS mechanism. We urge the Commission to proceed cautiously in this regard for several reasons.

First, ICLS and HCLS are paid to carriers on different bases. ICLS is paid to carriers initially based on projected data, and subsequently trued up to reflect actual amounts for the applicable year of payments.

Second, the data input needed to calculate ICLS is different than what is needed for the HCLS computations. As the Commission is aware, the ICLS payments in 2012 will reflect current accounting data. High cost loop support payments in 2012 reflect activity from the 2010 calendar. We believe it will require separate models to accomplish such a task.

We respectfully recommend that the Commission address the inadequacies with the current regression proposal prior to introducing more problems that are certain to occur with a regression modeling effort for ICLS.

Respectfully submitted,

Via ECFS at 1/17/12

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